

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200836001**

Release Date: 9/5/2008

CC:ITA:7:DHKIM
CAM-103274-08

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 167.03-01, 446.04-17

date: May 05, 2008

to: Chief, Planning and Special Programs, SB/SE (South Atlantic)

from: Chief, Branch 7, Office of Associate Chief Counsel (Income Tax and Accounting)
(CC:ITA:7)

subject: Denial of Request for Change in Method of Accounting

In accordance with section 9.12(2) of Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 40, this Chief Counsel Advice advises you that a taxpayer within your operating division has been denied its request to change its method of accounting. This Advice may not be used or cited as precedent.

LEGEND

A =

B =

C =

D =

This memorandum advises you that a request for change in method of accounting, filed B, on behalf of A, has been denied. A requested permission to change the useful life for amortization of leasehold acquisition costs, beginning with the taxable year beginning C ("year of change").

A is a partnership engaged in the real estate rental business. On B, A filed a request to change its method of accounting for leasehold acquisition costs. Under A's present method of accounting, A amortizes leasehold acquisition costs under section 167(a) of the Internal Revenue Code by using the straight-line method of depreciation and an average D lease term period regardless of the actual terms of the leases to which such

acquisition costs relate. The D period is a blended average of all leases entered into by A.

Under A's proposed method of accounting, A will amortize leasehold acquisition costs under section 167(a) over the actual terms of the leases to which such acquisition costs relate. A will continue using the straight-line method of depreciation.

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or of property held for the production of income. Except as otherwise provided under the Code, section 167(a) is the controlling provision for the allowance for amortization of intangible assets acquired prior to the enactment date (or election-back date, where applicable) of section 197 and for intangible assets that are excluded from section 197.

Section 1.167(a)-1(a) of the Income Tax Regulations provides that the allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or held by the taxpayer for the production of income is that amount that should be set aside for the taxable year in accordance with a reasonably consistent plan, so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of that property. The allowance shall not reflect amounts representing a mere reduction in market value.

Section 1.167(a)-1(b) provides that the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in its trade or business or in the production of the taxpayer's income. This period is determined by reference to the taxpayer's experience with similar property taking into account present conditions and probable future developments.

Section 1.167(a)-3(a) provides that an intangible asset known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, may be the subject of a depreciation allowance. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life.

Section 446(e) provides that a taxpayer who changes the method of accounting on the basis of which income is regularly computed in keeping its books shall, before computing its taxable income under the new method, secure the consent of the Secretary.

Section 1.446-1(e)(2)(i) provides that the Commissioner's consent must be secured whether or not the proposed method is proper or is permitted under the Code or the regulations thereunder.

For a depreciable or amortizable asset placed in service by a taxpayer in a taxable year ending before December 30, 2003, section 1.446-1(e)(2)(ii)(b) (as in effect prior to December 30, 2003) provides that a change in the method of accounting does not include an adjustment in the useful life of the asset.

For a depreciable or amortizable asset placed in service by a taxpayer in a taxable year ending on or after December 30, 2003, section 1.446-1(e)(2)(ii)(d)(3)(i) provides that a change in method of accounting does not include an adjustment in the useful life of a depreciable or amortizable asset for which depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L(c), former section 168, or an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d)). However, section 1.446-1(e)(2)(ii)(d)(3)(i) does not apply if a taxpayer is changing to or from a useful life (or recovery period or amortization period) that is specifically assigned by the Internal Revenue Code (for example, section 167(f)(1), section 168(c), section 168(g)(2) or (3), section 197), the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin and, therefore, such change is a change in method of accounting (unless section 1.446-1(e)(2)(ii)(d)(3)(v) applies).

In this case, A proposes to change the amortization of leasehold acquisition costs from using an average D lease term to using the actual lease term. This change is an adjustment in the useful life of the leasehold acquisition costs. Further, the present and proposed useful lives are not specifically assigned by the Code, the regulations under the Code, or other guidance published in the Internal Revenue Bulletin. Therefore, A's proposed change is not a change in method of accounting and, therefore, cannot be made through a request under section 446(e) to change A's method of accounting. Accordingly, we denied A's request.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4930 if you have any further questions.

GEORGE BLAINE
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